

9000 STATUTE OF LIMITATIONS

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9010 STATUTE OF LIMITATIONS - IN GENERAL

The Statute of Limitations (SOL) is a time limit imposed by law on the right of both the state and the taxpayer to increase or decrease self-assessed taxes. There are several statutes involved governing various situations. (See the statute of limitations chart in **MAPM 9030**.) Special attention should be given to any recent legislative changes to the statute of limitations.

The auditor should avoid opening an audit within 6 to 12 months of the expiration of the statute of limitations. The department's practice is to use good judgment, taking into consideration the taxpayer's compliance history, revenue impact, estimated time for completion, etc.

Our program goal is to complete cases within 2 years of initial contact or 4 years of filing, or within a reasonable period as dictated by the circumstances of the case. In achieving that goal, the use of waivers should be minimized. This must be balanced with the goal of resolving cases at the lowest possible level and the inherent complicated nature of some major multistate and multinational audits.

It is the auditor's responsibility to assure that the statute of limitations does not expire.

It is the auditor's responsibility to review each return immediately when assigned to determine the statute of limitations. The earliest statute date should be entered into PASS * * * * * and the auditor's inventory report. The case should be reviewed on a monthly basis. If necessary, a waiver extending the statute of limitations should be obtained. The auditor should also look ahead to future open years not yet assigned to audit to ensure that the statute is maintained for these years as well.

The department shares with the taxpayer an obligation to conform to the law. Audit activities and recommendations must conform to the time frames prescribed by statute. With few exceptions, audits are to be completed well within the normal four-year period allowed by law for proposing deficiency assessments. * * * * *

Audit activities must be planned and carried out so a reasonable effort on the part of the taxpayer can result in the completion of our audit within the normal statute of limitations. Waivers are not an acceptable substitute for prompt, timely audits. If the taxpayer's circumstances are such that this would create a substantial burden, the department will generally allow a reasonable extension of the statute of limitations expiration date. Since our objective is to obtain the information necessary to verify or correct the taxpayer's self-assessed tax, this alternative may at times be preferable to closing the case with insufficient information to support the audit conclusion.

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SITUATIONS WHERE A WAIVER MAY BE PREFERABLE:

- The FTB has delayed the audit per the taxpayer's request.
- An audit of earlier years is currently in process and the taxpayer does not wish to allow follow-up cycles to occur simultaneously, or FTB resource limitations exist.
- A federal audit is ongoing.
- There is a failure to adequately disclose information on the return.

Just as our work must be done in accordance with the statute of limitations, we are entitled to expect a reasonable degree of cooperation from taxpayers so that we can complete our work promptly. Taxpayers that are unable or unwilling to comply with legitimate audit requests cannot be allowed postponement just because they are "willing" to sign waivers; there must be a reasonable expectation on the part of the auditor that the necessary data will be forthcoming. If this is not the case, waivers are not a viable alternative. Uncooperative taxpayers should receive formal demands for information and, if necessary, penalties for failure to comply with these demands, within the normal SOL period.

For further details regarding penalties, see **MAPM 8000**.

EXPLANATION OF THE STATUTE IN THE NARRATIVE REPORT:

For any year being adjusted which the normal statute has expired, application of a special statute or type of extension (open state waiver, federal waiver, etc.) must be explained in the narrative. The explanation must include any dates upon which the statute is based, such as date of final determination of a federal change or date of the renegotiating payment. The statute date must be entered on FTB 6430 (**MAPM 7070**) and FTB 6833 (**MAPM 4040**).

Evidence of the open statute on any return is important particularly for the approval of a refund or credit or for consideration in a case in which a protest is filed on the grounds that the statute has expired.

NOTE: ((* *)) = Indicates confidential and/or proprietary information that has been deleted.

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9020 SPECIAL STATUTE

In connection with any return for which the normal four-year SOL has expired, consideration should be given to applying any special statutes and securing waivers if such statute is soon to expire.

The auditor should be aware that while we cannot issue a Notice of Proposed Assessment on a year barred by statute, adjustments can be made on the barred year to revise any carryover (deductions and/or credits) claimed on an open year. (Rev. Rul. 56-285; *Springfield Street Railway Co. v. U.S.*, 312 F.2d 754; *State Farming Co., Inc. v. Comr.*, 40 T.C. 774 (1963).) Also see Multistate Audit Technique Manual **MATM 8080** (net operating losses) and **MATM 9010** (tax credits) for additional information.

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9030 STATUTE OF LIMITATION CHART

Condition:	Notice of Proposed Assessment must be issued within:	Overassessment, Credit, Certification to the Board of Control, or Taxpayer Files within:
Normal	<p>The later of 4 years after:</p> <ul style="list-style-type: none"> - The original due date (R&TC section 19066), or - The date the return was filed (R&TC section 19057) <p>Note: This statute also applies to NPACAs</p>	<p>(For timely filed returns only), the later of:</p> <ul style="list-style-type: none"> - 4 years from the original due date, - 4 years from date filed, or - 1 year from date of overpayment. (R&TC section 19306) <p>See MAPM 9090 for statute of limitations on delinquent returns.</p>
State Waiver	<p>Period agreed upon (R&TC section 19067)</p> <p>Note: Applies to NPACAs</p>	<p>Period agreed upon if refund was not barred when waiver was signed. (R&TC section 19308)</p>
Omission in excess of 25% of gross income	<p>The later of 6 years after:</p> <ul style="list-style-type: none"> - The original due date (R&TC section 19066), or - The date the return was filed (R&TC section 19058) 	Not Applicable
Federal Waiver Signed	<p>The later of:</p> <ul style="list-style-type: none"> - 4 years after the return was filed, or - 6 months after the expiration of the federal waiver (R&TC section 19065) <p>Also see MAPM 9100</p>	<p>The later of:</p> <ul style="list-style-type: none"> - 6 months after the expiration of the federal waiver, or - The normal statute (R&TC section 19308) <p>See Note 1 below.</p>
Federal change (RAR or 1120x) reported by the taxpayer or IRS after the specified	<p>4 years after notification by either the TP or IRS (applicable for federal adjustments only) (R&TC section 19060(b))</p>	<p>The later of:</p> <ul style="list-style-type: none"> - 2 years from the date of the final federal determination, or - The normal statute

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period (6 months) See note 2 below		(R&TC section19311)
Federal change (RAR or 1120x reported by the taxpayer or IRS within the specified period (6 months). See Note 1 below. See also note 2 below	The later of: - 2 years after notification by the taxpayer or IRS - The normal statute If an amended return or RAR is received, FTB has 2 years from the date received to issue an NPA. (Applicable for federal adjustments only) (R&TC section19059)	The later of: - 2 years from the date of the final federal determination, or - The normal statute (R&TC section19311)
TP and IRS fails to report a federal change (due to an RAR or the filing of a 1120X)	Anytime (there is no statute of limitations). (R&TC section19060(a)) (Applicable for federal adjustments only)	The later of: - The normal statute, or - Two years from the date of the final federal determination. (R&TC section19311)
Bad Debt Erroneous Inclusion of certain recoveries	Not applicable	7 years from the due date of the return or the date filed (if timely) (R&TC section19312)
Involuntary conversion (deficiency attributable to gain on conversion)	4 years after notification by the taxpayer of replacement or intention not to replace. (R&TC sections 24945 and 19061)	Not applicable
Involuntary conversion (deficiency attributable to other gain on conversion)	At any time before the expiration of the period within which a deficiency for the last taxable year may be assessed. (R&TC section 24946)	Not applicable
Patronage Dividends (noncash dividends elected to be excluded.)	4 years from the date the taxpayer notifies the department that gains from noncash dividends are realized.	Not applicable

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	(R&TC section 24273.5(f))	
Bankruptcy	Statute of limitations date is suspended for up to 2 years or 30 days after FTB receives notice. See MAPM 14000 for Bankruptcy information. (R&TC §19089)	Not applicable
Unreported installment income	Within 4 years after the taxpayer ceases to be subject to tax. (R&TC section 24672)	Not applicable
Abusive Tax Avoidance Transaction (ATAT)	Eight years after taxpayer files a return Applicable for returns filed on or after January 1, 2000 (R&TC section 19755)	Not Applicable
TRANSFeree		
1. Original Transferee	Within 1 year after the expiration of the normal statute (R&TC section 19074(a))	Not applicable
2. Transferee of Original Transferee	Within 1 year after the expiration of the period of limitations of the preceding transferee. (R&TC section 19074(b))	Not applicable
3. Other than transferee certain distributions pursuant to Bank Holding Company Act.	5 years after distributing corporation notifies that the period prescribed in Section 4(a) of Bank Holding Company Act has expired.	Not applicable
Fraud, or no return filed	No limitation. Civil assessment may be made at any time.	Not applicable.

Note 1: Protest and appeals to the Tax Court, Circuit Court, etc may extend the Federal waivers. This would extend the agreed period as follows - 90 days after the final decision to assess. The State would then have 6 months from this last date to make assessments or allow refunds.

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Note 2: If an RAR or a 100x is included in a field audit file, the date the RAR or 100x was received should be stamped on the RAR or 100x.

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9035 EIGHT-YEAR STATUTE OF LIMITATIONS FOR TAX SHELTERS

Revenue and Taxation Code (R&TC) section 19755 allows the Franchise Tax Board (FTB) eight years after a taxpayer files a return to mail a proposed deficiency assessment relating to an abusive tax avoidance transaction (ATAT). This extended period is applicable for returns filed on or after January 1, 2000. For purposes of this section, ATAT is defined under R&TC section 19753(c) as "a plan or arrangement devised for the principal purpose of avoiding tax," including, but not limited to "listed transactions" as described in R&TC section 18407(a). (Also see chief Counsel Announcement 2003-1, Abusive Tax Shelters – California Listed Transactions.)

- For open or closed years where there is "some substantive evidence" (defined below) that tax benefits claimed relate to ATATs, the auditor can assert the eight-year statute of limitations (SOL). Auditors must obtain supervisor approval before opening otherwise closed years in reliance on R&TC section 19755.
- For open years where there is no substantive evidence that tax benefits claimed relate to ATATs, auditors should request waivers to extend the normal SOL rather than rely on R&TC section 19755. Auditors cannot rely on R&TC section 19755 to open otherwise closed years if there is no evidence that tax benefits claimed relate to ATATs.

To assert the eight-year statute of limitations, we must have some initial indication that tax benefits claimed relate to ATATs. However, the statutes do not provide any guidance on opening otherwise closed years where there is a potential deficiency related to an ATAT.

Administrative and judicial decisions involving nonfilers may provide guidance. In cases involving estimation of unreported income, the State Board of Equalization and courts have concluded that FTB has the initial burden of demonstrating that reconstruction of income is reasonable and rational. We need only to provide some substantive evidence linking the taxpayer with the unreported income. (*Appeal of Michael E. Myers*, 2001-SBE-001, May 31, 2002; *Rapp v. Commissioner* (9th Cir. 1985) 774 F.2d 932, 935.) Once we have satisfied this burden, our determination is presumed correct and the taxpayer has the burden of proving it wrong. (*Todd v. McColgan* (1949) 89 Cal. App.2d 509.) Failure to provide information within the taxpayer's control give rise to a presumption that such evidence is unfavorable to the taxpayer's case. (*Appeal of Don A. Cookston*, 83-SBE-048, January 3, 1983.) In no case can FTB's determination of the deficiency be arbitrary or without foundation. (R&TC section 19033(a).)

Our initial burden is satisfied when we have obtained "some substantive evidence" or have "reasonable and rational" belief that tax benefits claimed relate to an ATAT. Once we have satisfied our initial burden of demonstrating that the proposed deficiency is related to an ATAT, the burden shifts to the taxpayer to establish that the proposed deficiency is not related to an

ATAT. However, if the taxpayer is successful in meeting that burden, the proposed deficiency will be held invalid as not timely issued.

What constitutes "some substantive evidence" or "reasonable and rational" belief for cases involving potentially abusive tax avoidance transactions is subjective and will depend on the facts and circumstances of each case. "Some substantive evidence" might include information received from sources such as the IRS, promoters or other sources that indicates possible participation in a tax shelter. Such evidence might also include return information such as unusually large losses offsetting income, indication of movement of assets, sharp reduction in wages or other income as compared from one year to the next, significant changes in the apportionment factor as compared from one year to the next, etc. Information obtained from an audit of different years, or of related individuals or entities, may constitute "some substantive evidence" that the taxpayer participated in an ATAT.

Helpful Point:

The statutory definition of ATAT for purposes of asserting the eight-year SOL, includes transactions that constitute tax avoidance or aggressive tax planning, even though they may not be listed transactions or mass-marketed products. The definition provided under R&TC section 19753(c) provides that an ATAT is "a plan or arrangement devised for the principal purposes of avoiding tax," including "listed transactions" as described in R&TC section 18407(a). An item does not have to be the same as, or substantially similar to, a listed transaction in order to be an ATAT.

If the auditor has obtained "some substantive evidence" that tax benefits relate to an ATAT, a waiver is not required. For open years where the auditor has not obtained "some substantive evidence" that tax benefits claimed relate to ATATs, the auditor should request a waiver to extend the normal SOL rather than rely on the R&TC section 19755. The taxpayer may want to sign a waiver that only extends the SOL for the ATAT. However, recall that, in general, auditors cannot accept modified waivers. (See Audit Branch Policy Statement 98-2, Acceptance of Modified Waivers.)

If the auditor has not obtained "some substantive evidence" that tax benefits claimed relate to ATATs the auditor cannot assert the eight-year SOL. The auditor may want to ascertain whether a federal waiver is in place or if the statute of limitations can be otherwise extended pursuant to R&TC section 19058 for omission of income. (See APR 96-2.)

If an auditor closes a case under an SOL extended by a waiver, but the waiver is ultimately determined to be invalid, the auditor can fall back on the eight-year statute of limitations if the potential deficiency relates to an ATAT.

If it is later determined that a deficiency proposed under the eight-year SOL does not relate to an ATAT as required by R&TC section 19755, the eight-year SOL will. The entire assessment would be invalid.

An auditor can assert the eight-year statute of limitations even if evidence doesn't conclusively indicate that an item is related to an ATAT. If we have "some substantive evidence" or "reasonable and rational" belief that a case involves an ATAT, the burden is on the taxpayer to demonstrate that the suspect return position does not relate to an ATAT.

Failure to Provide Information

If the auditor has obtained "some substantive evidence" that tax benefits claimed relate to an ATAT, and the taxpayer refuses to provide information on the basis that suspected items are not related to an ATAT, the auditor should respond in a manner consistent with normal business practices (CCR section 19032). The auditor should make a formal demand for information. If the demand goes unanswered, the auditor may issue an NPA assessing the penalty for failure to provide information upon notice and demand pursuant to R&TC section 19133 and any other applicable penalty (such as interest-based or understatement penalties). The auditor should also consider issuing subpoena duces tecum.

9040 OFFSET OF BARRED REFUND

In the case of corporations, California Revenue and Taxation Code §19314, although not extending the statute of limitations for a claim for refund, permits an offset of a barred refund against a deficiency resulting from a transfer of items of income or deductions or both to or from another year for the same taxpayer, or for the same or different years if such items of income or deductions are transferred between affiliated taxpayers whose tax is determined based on combined reporting. The offset must be made within 7 years after the due date of the return on which the overpayment is determined.

In cases where the taxpayers are claiming overpayment pursuant to California Revenue and Taxation Code §19314 and the issues in question deal with straddle investments or tax shelters, the auditor should be aware of the following:

- If the straddles entered into were shams, then California Revenue and Taxation Code §19314 is inapplicable because there was never any item of income to report, let alone transfer; and
- If the straddles were disallowed because the transactions were not entered into for profit, then California Revenue and Taxation Code §19314 is inapplicable because the closing of each straddle transaction is considered a separate transaction. (Smith v. Commissioner, 78 T.C. 350 (1982).)

9045 RECOVERY OF ERRONEOUS REFUNDS

Under California Revenue and Taxation Code §19411, action for recovery of erroneous refund or credit may be brought within 2 years after the refund or credit was made, or during the period within which the department may mail a Notice of Proposed Assessment, whichever period expires later.

9050 SECURING STATE WAIVERS

To extend the normal statute for NPAs, refunds, or the six-month period after waiver of Federal normal statute, a waiver must be secured on form FTB 3570, Waiver Extending Statute of Limitations for Proposing Deficiency Assessments. The waivers must cover all California taxpayers. Either separate waivers or one waiver covering all corporations (attach list if necessary) must be obtained.

When a waiver has been obtained, it is the auditor's responsibility to have the SOL information updated on BETS and PASS.

Note: Under Regulation Section 19032, as soon as practicable after the return is filed, the Franchise Tax Board shall examine the return and determine the correct amount of the tax. Our program goal is to complete cases within 2 years of initial contact or 4 years from the date that the return was filed, or within a reasonable period as dictated by the circumstances of the case. Auditors should be requesting waivers only when warranted by circumstances of the case. Minimization of the issuance of waivers must be balanced with the goal of resolving cases at the lowest possible level and the inherent complexities of some major multistate and multinational audits.

The auditor must make an effort to secure a waiver when the statute will expire within six months:

- * All waivers should, if possible, have an expiration date that is the same as the statute date on the subsequent year's return. This will minimize the number of odd statute dates to be controlled.
- * The request for a waiver (Form FTB 3570) should not include the statement that the extension will extend the time for claiming a refund unless the period for claiming a refund has not yet expired.
- * An appropriate follow-up date on the letter must be used. This is necessary to assure that a protective NPA can be issued in the event a signed waiver is not received prior to the statute expiration date.
- * If a waiver cannot be secured for a short statute case, please provide an explanation on the workpapers and issue a protective NPA.
- * The waiver should be attached to the return for the most current year it relates to and a photocopy of the waiver attached to each return the waiver relates to, regardless of whether an adjustment is being made. A copy of the waiver should also be included in the workpaper file. It is the auditor's responsibility to verify that the statute is open.

To be valid, the waiver must be signed and dated by a principal officer, duly authorized representative or agent, or by officials of the corporation who are charged with the management of its fiscal affairs, particularly with reference to the preparation of its income tax returns. Such

officials would usually include the treasurer, secretary, tax director and tax manager. The waiver must indicate the title of the signer and be executed on or before the date the statute would otherwise expire.

The Legal Division has determined that a waiver signed by a corporate official other than a principal officer (president, vice-president, secretary, treasurer, and secretary-treasurer) cannot be accepted unless such official has been duly authorized by the corporation to so act. Moreover, waivers signed by a representative or attorney-in-fact must be accompanied by a power of attorney authorizing such signature. The waiver must indicate the title of the signer and be executed on or before the date the statute would otherwise expire. Again, the auditor is required to make sure that the evidence attesting to such authorization is attached to the waiver, if not previously provided. However, where prior waivers have been signed and accepted in the past, waivers signed by other than a principal officer will continue to be accepted until the years under audit have been closed. A waiver obtained from a corporation where no previous waiver is in force must be signed by a principal corporate officer or authorized official as stated above.

Note: If a waiver is being signed by a representative who is the designee authorized in a power of attorney, the auditor should verify that the power of attorney has not expired. In such case, there must be a current, valid power of attorney existing at the time that the waiver is signed.

Occasionally, a situation will be encountered where the statute of limitations will expire prior to the time that the NPA or other notice would be completed under normal procedures. In these cases, the auditor will take the following action:

1. If the statute of limitations will expire within 90 days from the date the auditor completes his/her work on a proposed assessment, or overassessment, the auditor will complete form FTB 7011 (RUSH). (See **MAPM 7090** for instructions on completing the form)
2. The form FTB 7011 is placed on the front of the file when the file is given to the reviewer. The form FTB 7011 is to be attached to the face of the file on the outside of the folder.
3. Enter the date that the notice(s) is to be mailed. Whenever possible, the Support Section should have at least ten working days to complete the case before the specified mailing date on the form FTB 7011.
4. If the statute will expire within 15 working days, complete the form FTB 7011, check box labeled "Walk-Through". The case should be walked to the supervisor of the first section or unit, which must act next, on the case. The supervisor of each section or unit to which the case is delivered on a walk-through basis will be responsible for walking the case to the supervisor of the next unit in the order of delivery.

CAUTION:

Where the corporation has filed a timely claim, the statute is extended only for the amount claimed. The auditor should always request an extension (FTB 3570) to keep the statute open for the state. The supervisor should approve any exception to this. If the representative declines to sign a waiver consideration must be given to insisting that the examination be conducted while the statute is open or to issuing appropriate provisional assessments.

WAIVER POLICY: 1992 AND SUBSEQUENT YEARS

In 1992, the terms and conditions of the Schedule R-7 "*Election to File a Unitary Taxpayers' Group Return*" were revised to clarify that a state SOL waiver signed by the key corporation would be binding on all members electing to be included in the group return. Therefore, beginning with taxable years filed with the 1992 Schedule R-7, auditors may obtain blanket waivers for taxpayers that were included in the original Schedule R-7 group return. The taxpayer name on the waivers should be shown as "*(key corporation) and Schedule R-7 Electing Members*."

As long as a Schedule R-7 for 1992 or subsequent was executed, the blanket waiver will generally be acceptable even if the auditor is proposing to decombine the taxpayers or if one or more of the taxpayers have been sold. Judgment should be used of course -- if a taxpayer is asking to terminate their R-7 relationship, the auditor should obtain separate waivers to avoid potential problems. (Likewise, single notices can be mailed to taxpayers filing on a 1992 or subsequent Schedule R-7 regardless of whether a taxpayer has been decombined or sold, but the auditor should consider issuing separate notices if the taxpayer so requests.)

Separate waivers will be needed for taxpayers that did not file as part of the Schedule R-7 group return. If the audit includes returns from more than one R-7 group of corporations, the key corporation of each Sch. R-7 group must execute a separate waiver on behalf of that group.

WAIVER POLICY: PRIOR TO 1992

Prior to 1992, the terms of the Schedule R-7 did not include an express authorization by the taxpayers for the key corporation to sign waivers on their behalf. In order to avoid potential controversy, the department's waiver policy was revised to require auditors to obtain either separate waivers from each taxpayer in the combined report, or powers-of-attorney authorizing the corporation handling the audit to execute waivers on behalf of the other members. An exception to this policy is permitted if all of the following criteria are met:

- The audit is not expected to result in decombination; *and*
- All of the taxpayers are still affiliated with the key corporation; *and*

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- The key corporation is a California taxpayer qualified with the Secretary of State; *and*
- The key corporation is financially stable, has substantial net assets to pay the affiliates' deficiencies, and has not shown any indication that they would be unwilling to pay the affiliates' portion of the tax; *and*
- The key corporation has acted in good faith in fulfilling its obligations to pay under the terms of the Schedule R-7 in the past (i.e., they have not tried to terminate an R-7 relationship, refused to pay the tax of a combined subsidiary, attempted to disregard a waiver executed on behalf of a subsidiary, etc.).

If all of the above criteria are met, the auditor may accept a blanket waiver signed by the key corporation on behalf of taxpayers included in the Schedule R-7 election. Separate waivers must still be obtained from any taxpayers that have been disaffiliated or are expected to be decombined. An explanation of how the above criteria were satisfied should be included in the audit narrative. Even if the above criteria applies, auditors should still consider obtaining separate waivers in cases where intrastate apportionment would result in a large potential tax liability being attributed to a taxpayer other than the key corporation.

Note: This policy applies to all pre-1992 taxable years with open SOLs, including years that are open under previously executed state waivers. However, for pre-1992 taxable years that are already under a blanket state waiver, the auditor may continue to accept a signature by the parent or key corporation on behalf of its affiliates. Although such waivers are still valid, if there is an open federal waiver the auditor should obtain separate state waivers in order to comply with the department's waiver policy.

Waivers should be signed by a principal officer (president, vice-president, secretary, treasurer, etc.) or duly authorized agent of the taxpayer. A tax manager is not often a principle officer, so before accepting a waiver signed by a tax manager (or other corporate official other than a principal officer), the auditor should obtain a power of attorney or other evidence that the corporation has duly authorized the official.

In lieu of repeatedly obtaining separate waivers from each taxpayer every time a SOL extension is needed, auditors may obtain a power of attorney from each taxpayer. If the taxpayers designate a common agent to sign the waivers, then single waivers can be obtained from that point onward. The FTB Form 3520 is a power of attorney form designed specifically for this purpose. If several taxpayers in a combined report have a principal officer or other authorized individual in common, then those taxpayers may use the form to execute a single power of attorney. In most cases, the appointee who is granted the authority to sign waivers should be the member of the combined report that is handling the audit.

SUSPENDED CORPORATIONS

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Although a waiver signed by a suspended corporation will be accepted by the department, there are risks involved, which would cause the waiver to be subject to voidability. Therefore, the auditor must ensure that the key corporation that signs the waiver on behalf of itself or a group is not suspended.

9060 WAIVER FOR FORMER MEMBERS OF A COMBINED REPORT

Since 1992, taxpayers that make a Schedule R-7 election to file a group return agree that the key corporation will act as agent and surety on behalf of the other electing taxpayers. This gives the key corporation authority to sign waivers on behalf of affiliates included on the R-7. The Schedule R-7 authority continues to be valid for that taxable year even if the taxpayers are later disaffiliated unless the taxpayer informs the FTB that they are terminating the R-7 relationship. Because there are no instructions for how to terminate the R-7, it's appropriate to use some judgment to determine whether they want to terminate the R-7. But, if the key corporation has indicated that they are not on good terms with the sold subsidiaries and want them to be separately billed, then written confirmation must be obtained as to whether they wish to terminate the R-7 relationship.

When a federal waiver exists, the state SOL is extended under California Revenue and Taxation Code §19065. This provision applies even if the former parent on behalf of the subsidiary signed the federal waiver.

A principal corporate officer must sign a waiver when no previous waiver is in force. However, where prior waivers were signed and accepted in the past, waivers signed by other than a principal officer will continue to be accepted until the years under audit have been closed.

9070 WAIVERS FOR CORPORATE GROUPS IN DIVERSE BUSINESS ACTIVITIES

Situations may occur where corporate groups are involved in diverse business operations. A group of subsidiaries of the grandparent may be unitary, but not with other affiliated segments. State law provides that a waiver is only valid with respect to entities in the combined group. For this reason, the waiver should indicate the grandparent's corporate name and state "and Schedule R-7 electing Subsidiaries".

9080 FACSIMILE (FAX) WAIVERS AND POWERS OF ATTORNEY

A facsimile or photocopy is acceptable as evidence that the waiver or power of attorney has been signed. Our research indicates that the IRS now accepts fax copies of these documents. However, to avoid evidentiary problems if the authenticity is later questioned, auditors should attempt to obtain the actual document.

POWERS OF ATTORNEY

In its 11/91 revision to Publication 947, Practice Before the IRS and Power of Attorney, the IRS announced that it will accept a copy of a power of attorney that is submitted by facsimile transmission.

WAIVERS

California Revenue and Taxation Code §19067 is based on and substantially similar to Internal Revenue Code §6501(c)(4). As explained in Treas. Reg. §301.6501(c)-1(d), the extension becomes effective when the agreement has been executed by both parties; i.e., upon signature. There is no requirement in the statute that the waiver be mailed or transmitted to the Franchise Tax Board.

9090 SECURING WAIVERS ON DELINQUENT RETURNS**CAUTION:**

The normal statute for issuing Notices of Proposed Assessment for **delinquent** returns expires four years from the date filed. However, for issuing refunds, the statute expires four years from the due date of the return or one year from the date of payment, whichever is later. This, in effect, creates a "gap" between the SOL for refunds and deficiency notices. Therefore, the request for a waiver (form 3570) should not include the statement that the extension will extend the time for claiming a refund unless the period for claiming a refund has not yet expired. If necessary to request a waiver, auditors should request waivers that will keep the statute open for both assessments and refunds, when possible.

In the list at **MAPM 9030**, where "not applicable" is shown in the third column, the statute for filing a claim should not be extended.

9100 FEDERAL WAIVER

Always try to execute a valid California waiver extending the statute of limitations, as opposed to relying on a federal waiver.

Our program goal is to avoid opening an audit within 6 to 12 months of the expiration of the statute of limitations; to complete a case within 2 years of initial contact or 4 years of filing; and to limit the use of waivers. When seeking a waiver is necessary, it is preferable to have a valid California waiver. Statutorily, we can and will assess an NPA based on an open federal waiver, if we do not have a valid California waiver. However, with the reliance of a federal waiver, there comes some uncertainty; federal-state differences that have not been tested in the courts, such as:

- The termination date of the federal form 872A waiver
- Members included in the combined report versus the consolidated return
- Schedule R-7 issues
- Questions raised by a suspended corporation status
- Whether the federal waiver covers state-only issues

The better approach, especially with a large-dollar assessment, is to acquire a state waiver. If the taxpayer will not execute a state waiver, attempt to complete your case by the original or extended statute of limitations (by California waiver.) If this is not possible, coordinate with your supervisor to determine the best approach to complete the case.

If the normal state SOL has expired for any year and there appears to be a possible adjustment, the auditor should ascertain from the taxpayer or the taxpayer's representative whether there is a federal waiver. If the taxpayer claims there is no federal waiver, inquiry should be made as to whether a federal audit is in progress, whether a federal audit was completed, and whether an RAR was issued. If an RAR was issued, the auditor should ask the taxpayer whether any issues were protested. If an IRS audit is either in progress or if an RAR was issued which the taxpayer contested, a federal waiver will almost always be present. The IRS has two types of waivers:

Form 872 - provides specific taxpayer(s), taxable years and extended date

Form 872A - open-ended statute with no specific extended date

Taxpayers filing consolidated 1120's will have one Form 872 for the consolidated group. If there are two or more California qualified corporations in the group, the federal waiver would apply to all corporations in the group. The IRS uses form 872A for cases that have been appealed. The form precludes the need of keeping track of extended statute dates and provides that the IRS can issue a notice 90 days after final determination at the appeal level. Since the department does not coordinate extended statute dates with the IRS, the auditor

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should always try to secure a state waiver even though there is an existing federal waiver. If the taxpayer will not execute a state waiver, prompt action should be taken by the auditor to complete the case.

Note: If the auditor has reason to believe that a federal waiver might be present and the taxpayer is not being cooperative, the auditor should request an IRS BMF transcript. This transcript will disclose whether a federal waiver is present. To obtain an IRS BMF transcript, fill out an FTB 6227 and send it to the IRS Coordinator who is in the RAR Unit. The RAR Unit is within the Federal and State Special Audit Section. * * * * *

The supervisor should always be kept informed of the earliest statute date. This is particularly important if an adjustment is being proposed and the normal statute is extended due to an existing Form 872 or 872A. There must be evidence in the file to substantiate that the statute is open before notices can be issued.

California Revenue and Taxation Code §19065 provides that the state SOL remains open for 6 months after the expiration of the federal waiver. The question arises as to whether the 6-month period begins to run on the stated expiration date of the federal waiver or the date of the earlier final federal determination. The current policy is that the SOL remains open for 6 months after the stated expiration date even if there has been an earlier final federal determination. However, to protect the state's interest, it is always best to issue the assessments within the 6 months of the final federal determination. If the 6-month period has passed before you discover that the final federal determination was reached, legal will still defend the assessment as long as it is issued within 6 months after the stated expiration date on the federal waiver. Based on this analysis, claims for refund should be considered timely if they are received within 6 months after the stated date on the federal waiver even if a final federal determination occurred prior to that date.

In all cases involving an overpayment, when the statute would have normally expired prior to the date the Claim for Refund was filed (or the date credit is allowed) but for the existence of a federal waiver, it will be the responsibility of the auditor to have the taxpayer submit a copy of the waiver document.

NOTE: ((* *)) = Indicates confidential and/or proprietary information that has been deleted.

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9110 PROCEDURES FOR ACCEPTING MODIFIED WAIVERS

DEFINITION OF MODIFIED WAIVERS

A modified waiver is any waiver that has been altered in any manner from that which was originally sent by the auditor to the taxpayer or representative. The following are examples of modifications.

- Alterations on the waiver form which change the extended statute date.
- Alterations to the waiver outlined in a cover letter and included with the signed waiver.
- Alterations on the waiver form which limit the applicability of the extended statute (i.e. to certain issues or dollar amounts).

SPECIFIC PROCEDURES

The current policy is **not** to accept a modified waiver. Auditors must obtain an unaltered waiver or complete the case within the normal statute of limitations.

However, it is understood that there may be some factual circumstances where it may be in the state's best interest and the taxpayer's best interest to accept a waiver that limits the applicability of the extended statute. Therefore, in these limited situations, the auditor must follow the approval procedures outlined below prior to accepting a modified waiver.

1. The auditor will inform his/her supervisor that a modified waiver has been proposed and/or received which seeks to limit the applicability of the extended statute and discuss the reasons why the limitations should be accepted.
2. Once the auditor and supervisor agree that it is in everyone's best interest to accept the proposed limitations, the auditor will contact the appropriate Technical Resource Section (TRS) member, and provide:
 - All facts, circumstances, and risks associated with accepting the modified waiver, and
 - The basis and recommendation as to why the waiver should be accepted.
3. The TRS member will advise the auditor of whether or not the recommendation is appropriate. If it is appropriate, the TRS member will ensure the modified waiver contains the necessary language to sustain challenges of validity. The TRS member will use the facts and circumstances of each contact to monitor the policy for consistency and application of the exception rule.

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4. The auditor will complete a memorandum documenting the items as listed in Step #2 above and include all contacts with the taxpayer and TRS.
5. The memorandum will be signed and dated by the supervisor.
6. A copy of the signed and dated memorandum will be provided to the TRS member involved and the original will be kept in the case file.

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